

Mexican Industrial Real Estate Opportunities

By Gonzalo Gutierrez, SIOR



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Mexico's Economic Outlook

With a population of approximately 110 million, Mexico is the second largest country in Latin America, and the third largest in population in the entire hemisphere. Mexico, along with Canada, China, and Japan, are the United States' top four trade partners. These four countries consume more than 47 percent of U.S. exports.

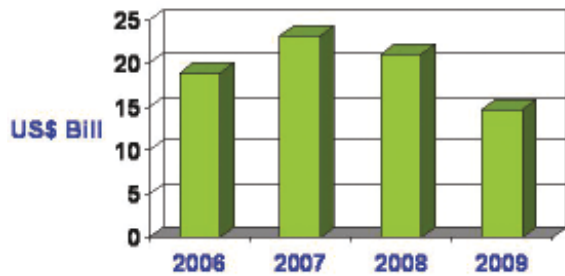
Mexico has long been a leader in the global manufacturing market. Many Fortune 500 companies and other multinationals have turned to Mexico in an attempt to cut manufacturing costs while maintaining U.S. standards of quality and efficiency.

Mexico is highly dependent on and interlinked with the U.S. economy through various trade agreements, most notably the North American Free Trade Agreement (NAFTA). Unfortunately, the effects of the world financial crisis in 2009 and

the U.S. recession have resulted in difficult times for Mexican industrial markets. Foreign Direct Investment (FDI) in Mexico plunged 30 percent in 2009, as the world financial crisis bit into capital inflows. Companies from the United States, Canada, Europe, and Asia invested only \$14.7 billion in Mexico in 2009, compared to \$21 billion in 2008 and \$23 billion in 2007. Half of the capital investment in the form of FDI was meant for the manufacturing sector. Remittances from Mexicans working in the United States fell from \$25 billion in 2008 to \$21.2 billion in 2009, a 15.7 percent decrease. That drop was caused by a drastic decline in such key economic sectors as construction, manufacturing, and the automotive industry. Nevertheless, remittances remain as the second most important source of foreign income for Mexico.

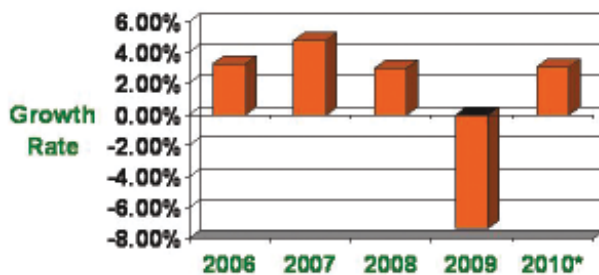
Following are historical tables for FDI and the GDP Growth Rate:

Foreign Direct Investments



Source: Secretary of Economy—Mexico

Gross Domestic Product



Source: Secretary of Economic Development—Mexico

Given that there are already strong signs of recovery this year, some economic specialists estimate that GDP will grow—led by growth in export manufacturing—at a 3.3 percent rate in 2010 despite a global environment of uncertainty. However, sustained growth will depend largely on pending structural reforms such as fiscal and labor reforms. The delay in the reforms puts Mexico in an unfavorable position, when compared to the rest of Latin America.

Industrial Market Overview

Mexico's *maquiladora* industry endured the 2009 crisis, and the encouraging news is that the last quarter of 2009 saw early signs of recovery in many markets. *Maquiladora* is used to describe companies that process (assemble and/or transform in some fashion) components imported into Mexico that are, in turn, exported, usually to the United States. With many foreign companies turning to the maquiladoras for labor-intensive manufacturing processes such as assembly, packaging, sorting, and repair work—the 35-year-old industry is continually evolving. It is the primary export industry and one of the largest generators of foreign exchange. More and more, Mexican maquiladoras are providing their workers with extensive training that prepares them to handle a wide range of highly skilled manufacturing positions with quality, efficiency, and an exceptionally high level of productivity.

More than 1,000 auto parts companies are located in Mexico; the United States accounts for 37 percent, Germany 30 percent, and Japan 10 percent of these companies. The auto industry accounts for 17 percent of the manufacturing GDP. In the 1990s and until 2001, the industry experienced a decade of strong growth and consolidation, a significant technological leap, and the long-awaited geographical dispersion of operations throughout Mexico. Currently, GM has four different manufacturing and assembly plants in Mexico, Ford has three, and Nissan, Toyota, and Honda each have one. In addition, for more than 30 years, Chrysler has been in Saltillo and Mexico City, and VW has been in Puebla.

During the past five years, Mexico has also seen growth in the electronics industry with companies such as Sanmina SCI in Guadalajara, Jabil in Reynosa, and Foxconn and Flextronics in Juarez, among others. More recently, the aerospace and aeronautical industry has arrived in force with important companies. In 2007, specialists predicted that the aeronautical industry in Mexico would reach 200 plants by 2010. The goal is now well within reach.

With the geographical dispersion of industrial operations throughout Mexico, many industrial markets were consolidating with high-class industrial parks built to international construction standards. Industrial parks have evolved in Mexico over the last 25 years. They are now strategically located where there is an abundant labor force, access to major transportation corridors, access to U.S./Mexico border crossings in the border markets, and guaranteed availability of utility infrastructure.

Regional Market Overview

The Mexican industrial market is divided into three main regions: Northeast, Northwest and Central, with 15 principal industrial markets.

Northeast Region

Monterrey—Monterrey is the second largest industrial market in the country, with a highly skilled, highly educated labor force. Such companies as Ternium, Whirlpool, Cemex, Lego, Bridgestone, and Maseca, among others, have selected this market to establish their campus operations.

Reynosa—This market is located in one of the most dynamic border areas, with McAllen, Texas, on the U.S. side.

Saltillo—Saltillo is known as the “Mexican Detroit.” GM and Chrysler have located their assembly plants there and auto parts suppliers have followed them. The current vacancy rate is low at 5.5 percent, and investors are still developing new industrial parks with very good infrastructure.

Nuevo Laredo—This market represents one of the most important cross-border transportation corridors in North America, with more than 10,000 daily truck crossings. Laredo (Texas) and Nuevo Laredo form the United States' largest inland port. Approximately 70 percent of the

Fortune 1000 companies' trans-ship finished goods and raw materials through this port of entry which accounts for 65 percent of the total commercial trade operations in Mexico.

Matamoros—In 2009, Delphi, the largest maquiladora employer in Mexico, closed three plants here, helping to push the vacancy rate to 16 percent. Located near the Gulf of Mexico, and across the border from Brownsville, Texas, Matamoros is a world-class manufacturing center with one of the most stable available labor forces along the U.S./Mexico border.

Northwest Region

Ciudad Juarez—In 2009, manufacturing activity dropped significantly and investment stopped. The vacancy rate jumped from 6.65 percent in 2008 to 12.57 percent in 2009. However, the border cities of Cd. Juarez and El Paso combine to provide a highly efficient value chain platform that international companies have long used.

Chihuahua—Chihuahua has a solid position among Mexico's secondary manufacturing markets and has experienced stable economic growth for the past 10 years.

Hermosillo—This market has quickly established itself as an important Mexican industrial market for the automotive industry. Aiding its development has been its strategic partnering with Arizona.

Mexicali—Mexicali is home to some of the leading international aerospace companies with operations that range from manufacturing to assembly. The processes of the aerospace companies are more complex than traditional manufacturing, therefore, in addition to its production facility, Honeywell has built a new state-of-the-art design center.

Tijuana—Located along the California border, this market has a population of 1.4 million and is one of the most important border crossings in the Otay-Mesa area. About 25 percent of total commercial trade operations in Mexico are made through this market. Main industries here include consumer electronics and medical operations. Located on the Pacific Coast, this area has attracted many companies from Asia.

Central Region

Mexico City/Toluca—Mexico City is one of the largest metropolitan areas in the world with more than 22 million inhabitants. This market has more than 90 million square feet of Class A and B industrial inventory and all types of industry. There are nine sub-markets in this huge metropolitan area. Toluca, a 30-minute drive from Mexico City, has a growing industrial park infrastructure with industrial buildings meeting high construction standards.

Puebla—Puebla is the home of VW in Mexico and has 12 million sq. ft. of industrial inventory with a 45 percent concentration in the automotive industry. Puebla has a diversified economic base with growth rates above the

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national average, excellent transportation infrastructure, proximity to Mexico City and the port of Veracruz, and a stable, highly-skilled labor force.

Queretaro—Queretaro offers a highly-qualified labor pool and has a new Aerospace Industrial Park. Companies from Ireland, the United States, and Canada have facilities here.

Guadalajara—With 27 million sq. ft. of industrial inventory, Guadalajara is Mexico's fourth most important city. It relies on the establishment and growth of both national and multinational industries, particularly metal mechanics, electronics, plastics, food, and logistics.

San Luis Potosi—Located in the Mexican heartland, it is equidistant from Mexico City, Monterrey, and Guadalajara and is considered an important logistics hub. Two years ago, General Motors acquired more than 700 acres of land there to build their fourth Mexican plant. This new complex will also attract auto parts suppliers.

The chart on page 34 offers specific industrial market statistics.

Logistics in Mexico

A growing number of international companies are successfully using offshore manufacturing and efficient supply/demand chains management in Mexico. Not only North American, European, and Japanese companies but also Chinese and Indian companies are locating distribution facilities in Mexico, enjoying the advantage of Mexico's proximity to the American market. Mexico is the largest exporter in Latin America and ranks 15th globally.

Mexico meets international supply chain requirements throughout the border region and also around the very important container ports on both sides of the country. Four ports—Manzanillo and Lazaro Cardenas on the Pacific side and Veracruz and Altamira on the Gulf of Mexico side—handle about 70 percent of Mexico's ocean-bound freight. Mexico's strengths tend to favor companies that manufacture highly-customized products that are particularly sensitive to shipping cost and lead times. As the deep-water port closest to the United States, the quickly growing industrial Port of Altamira holds a critically important strategic position for implementing NAFTA, as well as other free trade agreements between Mexico, the European Union, and many Latin American countries.

Leasing Activity

With high levels of vacancy, leasing activity in 2009 dropped in most—but not all—markets. Compared to 2008, leasing activity in 2009 dropped 50 percent in Ciudad Juarez, Puebla, and San Luis Potosi, and 40 percent in Monterrey. However, activity rose by 11 percent in Reynosa, 35 percent in Nuevo Laredo, and 20 percent in the Mexico City-Toluca area.

While the world economy continued to sputter, many of the industrial markets were fortunate enough to show sporadic demand, with multinational companies taking available space. Due to current market conditions, we've seen many tenants recognize that now is the time to lock in lower lease rates for an extended period of time.

Vacancy Rates

The slowing of industrial activity in many markets during 2009 resulted in lower absorption levels than we had initially predicted. Some markets showed signs of improvement during the last quarter of 2009, and leasing activity increased slightly during the first quarter of 2010. Nevertheless, in most industrial areas, vacancy rates were still at unhealthy levels due to previously pending speculative developments that were brought on-line

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by institutional and local Mexican developers. The higher vacancy rates were exacerbated by the slower leasing activity in 2009. In addition, many companies downsized operations during the world economic crisis. Developers remain cautiously optimistic and landlords are being aggressive to retain tenants—now benefiting from market conditions that allow them to negotiate better lease rates for new space and renewals. No doubt that this is still a buyer's market.

Realty, GE-Intramercia, Corporate Properties of the Americas and Kimco have established a presence in most major markets. Between 2003 and 2007 when demand was increasing with the arrival of new manufacturing companies and logistics suppliers, most of these developers increased speculative development in order to respond to this demand in a timely manner. However, since the first quarter of 2009 new construction activity has virtually ceased and now the objective is to lease existing inventory.


Developer and Construction Overview

In the late 1990s through the early 2000s, multinational real estate developers such as ProLogis, AMB and Hines entered the Mexican market with the vision of establishing a solid building base to offer state-of-the-art industrial buildings. Important investment funds and developers such as Prudential, ING Capital, Ridge Property Trust, Green

Forecast

We have begun to see signs of recovery in the Mexican economy and thankfully, the telephone is ringing again. Most developers active in Mexican industrial markets agree that leasing increased in the first quarter of 2010 and that, if we continue to see sustainable improvement in the economy, we could easily estimate a second half of 2010 with improved results. Nevertheless, for current projects in the pipeline or for planned new projects, the decision-making process will proceed more cautiously, especially in the border markets.

Companies will need to carefully evaluate economic variables and financial considerations before making final facility decisions. The already adjusted lease rates are expected to remain flat throughout 2010, and this should help move the vacancy levels toward equilibrium.

The skilled labor force, low labor costs, logistics advantages, supplier base, and North American opportunities will continue to attract companies to Mexico. We expect to see a modest number of new site selection projects again, considering that Mexico and the industrial markets are expected to show continued slow recovery throughout 2010 that will lead to accelerated growth in 2011. 

Industrial Markets in Mexico Overview / Year-End 2009

	Population	Market Size (Thou) SqFt	Vacancy Rate *	Lease Rates (SqFt/Year) **	Land Cost (per SqFt) ***
Northeast					
Monterrey	4,050	94,300	8.9%	\$3.24 - \$4.68	\$3.53 - \$6.50
Reynosa	1,250	30,846	12.0%	\$3.24 - \$4.44	\$2.13 - \$4.18
Saltillo	950	30,533	5.9%	\$3.48 - \$4.68	\$2.60 - \$3.71
Nuevo Laredo	690	8,804	9.5%	\$3.36 - \$4.44	\$2.60 - \$3.90
Matamoros	850	16,237	16.0%	\$3.48 - \$4.68	\$2.13 - \$4.18
Northwest					
Ciudad Juarez	1,350	58,500	12.6%	\$3.75 - \$5.25	\$3.25 - \$4.25
Chihuahua	877	17,181	11.0%	\$3.50 - \$4.75	\$3.25 - \$4.00
Hermosillo	730	7,217	7.5%	\$3.00 - \$5.50	\$2.90 - \$3.40
Mexicali	1,030	19,564	9.3%	\$3.60 - \$4.20	\$2.30 - \$4.00
Tijuana	1,540	53,230	14.8%	\$4.08 - \$4.92	\$6.50 - \$7.90
Center					
Mexico/Toluca	21,000	90,300	10.2%	\$4.56 - \$5.16	\$7.43 - \$12.07
Puebla	1,630	12,210	16.7%	\$3.84 - \$4.98	\$3.53 - \$6.50
Queretaro	634	17,455	11.3%	\$3.84 - \$4.80	\$3.53 - \$4.18
San Luis Potosi	785	18,500	5.7%	\$3.36 - \$4.44	\$2.40 - \$3.71
Guadalajara	7,000	27,900	10.3%	\$3.84 - \$4.98	\$6.50 - \$12.07

* Only Class A and B available buildings

** Lease rates in US dollars per square foot per year for a Class A and B buildings with "basic improvements" inside.

*** Sale price per square foot for fully developed land with utilities infrastructure and paved roads

SOURCE: Cushman & Wakefield Mexico - Market Research Department